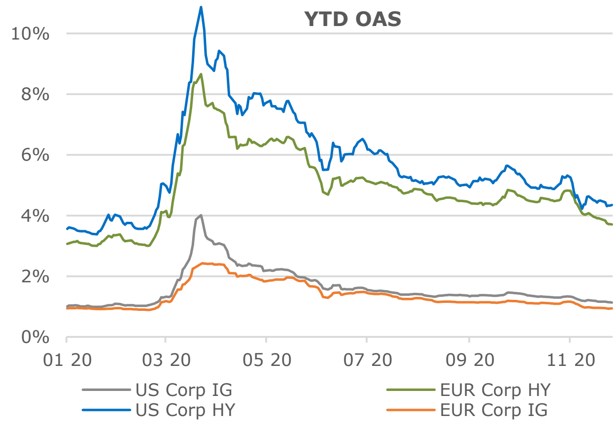
Monthly Spotlight

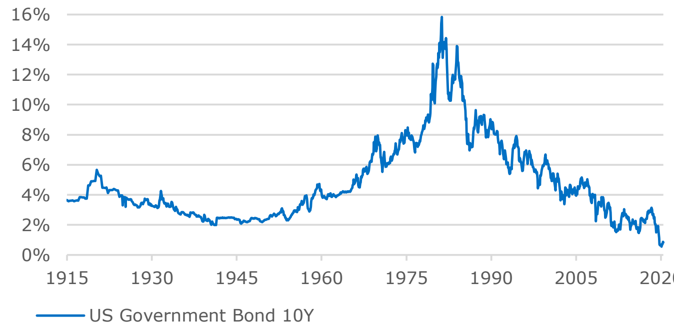
IG credit spreads almost reached pre-Covid levels

During the market rally in November credit spreads have further tightened and reached almost pre-Covid levels in the investment-grade category, whereas spread levels are still wider in the high-yield market. OAS of broad US investment-grade corporate bonds are now only slightly higher (112 bps) in comparison to the start of 2020 (99 bps). US high-yield bond prices jumped in November with the positive vaccination news and as these bonds are more cyclical in nature and strongly benefit when the broader economy further "normalizes". Meanwhile, investment-grade bonds will be challenged at some stage with their embedded "duration" feature. While short term rates will remain low, the yield curve might steepen heading into 2021.

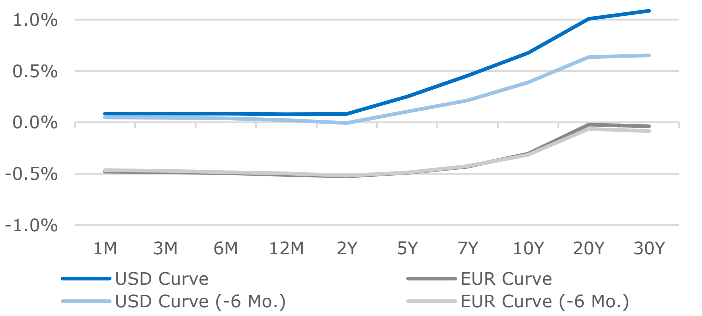


Rates Perspective

1) Historical US Treasury Yield: 10-year US government bond yield reached its 100-year low of 51 basis points in 2020.

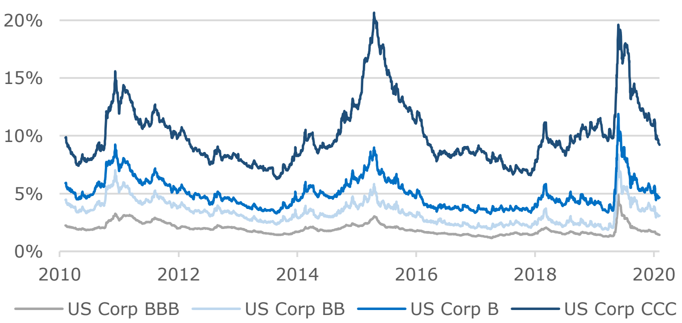


2) Interest Swap Curve: USD swap curve has further steepened due to cyclical recovery hopes. EUR swap curve remained unchanged.

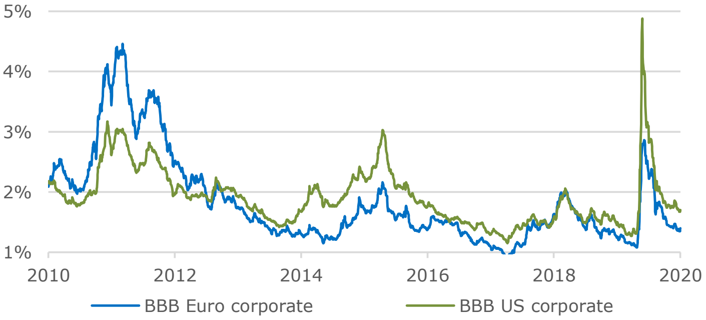


Corporate Perspective

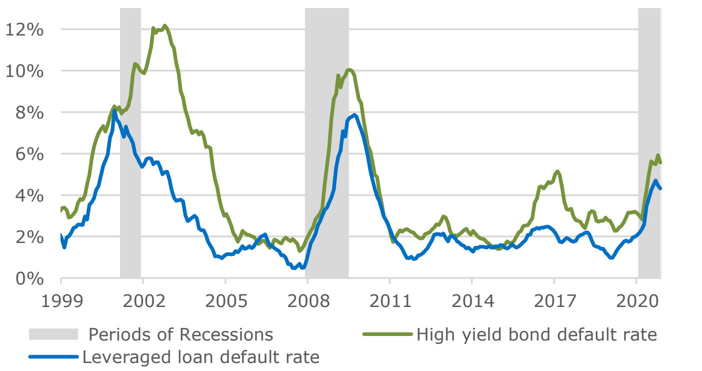
3) US Corp. Rating: In November 2020, credit spreads (OAS) of CCC-rated bonds even tightened in the energy and transport sector.



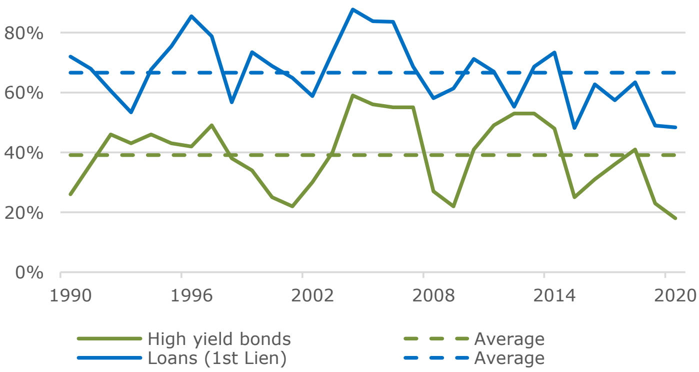
4) EU vs US: Since the March-spike, credit spreads (OAS) between the USA and EU have converged in tandem to lower levels.



5) Default Rates: Default rates of HY bonds & loans are peaking. HY bond default rates are structurally higher (Ø4.4%) vs. loans (Ø2.8%).



6) Recovery Rates: Recovery rates of leveraged loans are higher (Ø67%) vs. high yield bonds (Ø39%) due to lower severity.



OAS spread change overview across major credit asset classes - as of month end

US corporates by rating (bps)

	curr	Δ monthly
AAA	59	-13
AA	69	-13
A	84	-15
BBB	143	-28
BB	308	-76
B	465	-103
CCC	922	-219

Global high yield (bps)

	curr	Δ monthly
US HY	433	-92
EU HY	369	-112
Asia HY	799	-83
EM HY	471	-94

CDS spreads (bps)

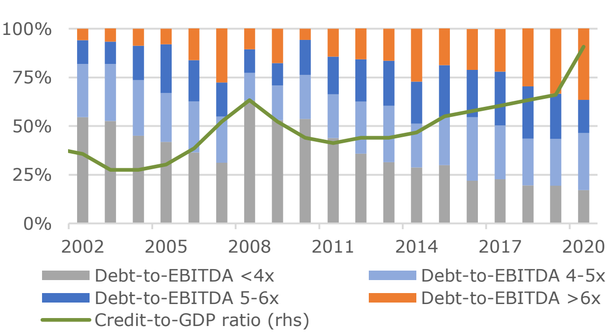
	curr	Δ monthly
iTraxx IG - EU	51	-14
CDX IG - US	49	-17
iTraxx XO - EU	307	-114
CDX HY - US	267	-103

Loans and CLOs (yld, bps)

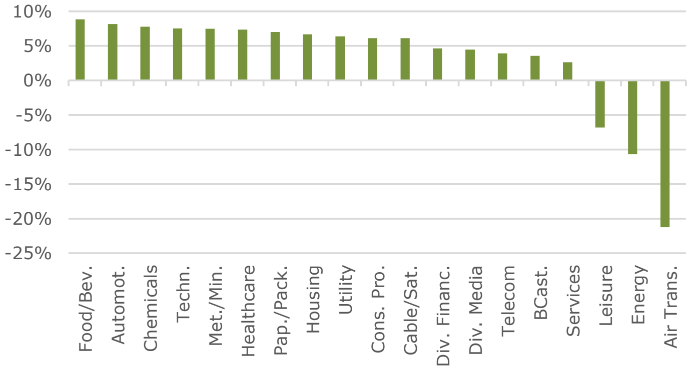
	curr	Δ monthly
US Loan	415	-64
CLO AAA	151	-27
CLO BBB	432	-74
CLO BB	828	-138

spread tightening (positive price action)
spread widening (negative price action)

7) US Leverage: Debt-to-EBITDA of US companies decreased in Q1 2020, but increased to a record high in Q3 2020.

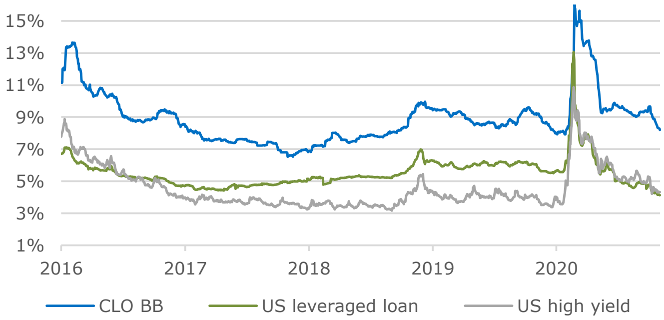


8) YTD Sector High-Yield Returns: Year-to-date Leisure, Energy and Air Transportation are the only sectors still performing negative.

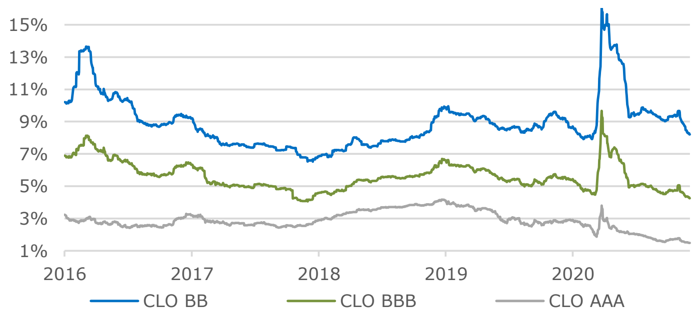


Alternative Perspective

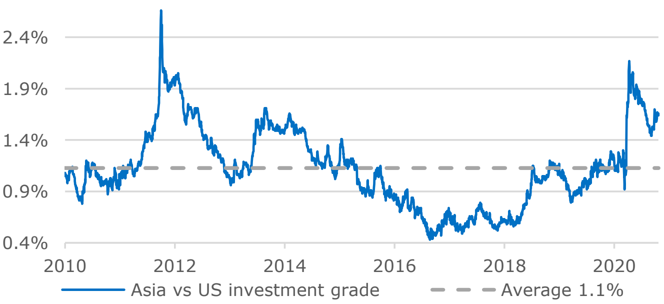
9) Loans vs. CLO vs. HY: CLO prices rallied strongly, what tightened CLO BB yields to 827 bps, but remain much wider vs. "peers".



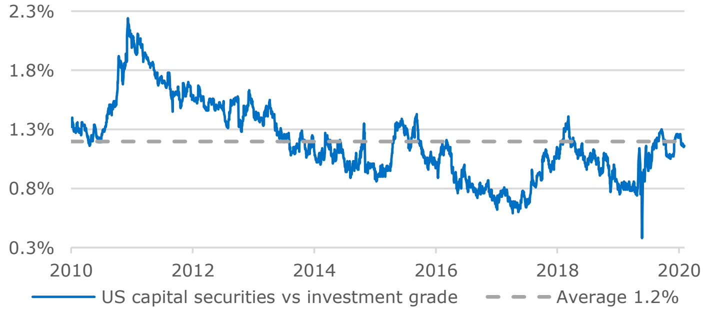
10) CLO Yields: CLO yields offer a significant yield premium vs. bonds/loans, whereas BB/BBBs look particularly attractive.



11) Asia vs. US: USA IG spreads have tightened more than in Asia, and we identify more attractive value in Asia than in the U.S.



12) Capital vs IG.: Capital Securities structurally earn a premium vs. US IG bonds. Capital Securities are dominated by the financial sector.



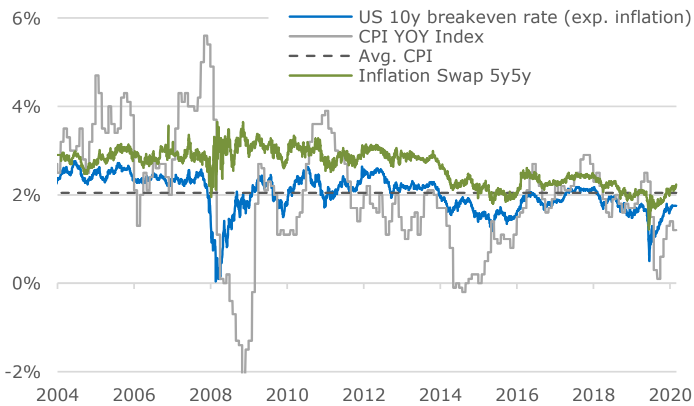
Education Corner

TIPS in the current environment

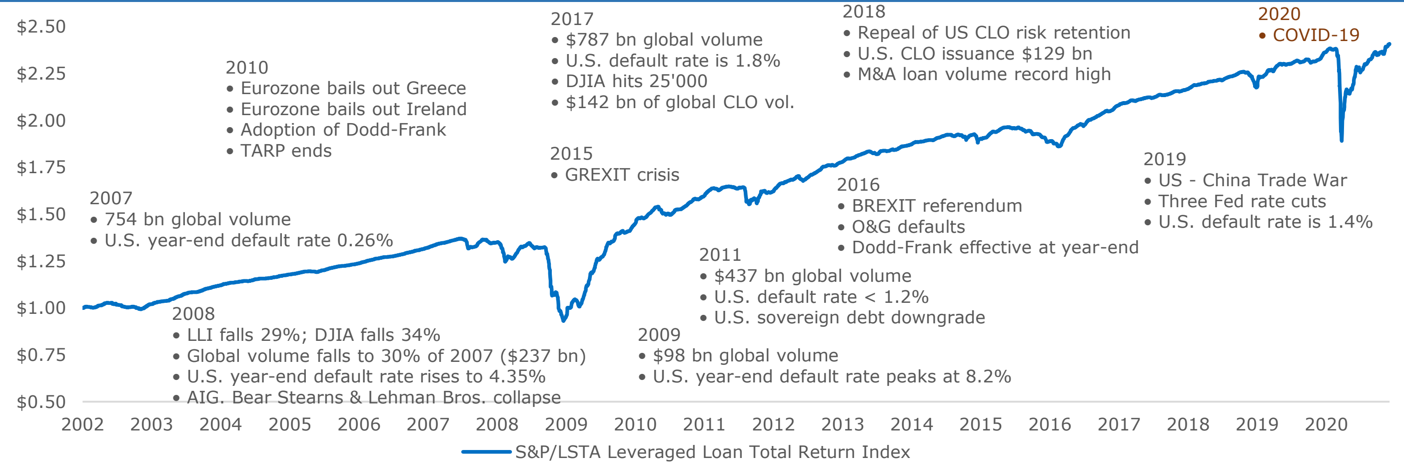
As described in the month before, buying TIPS makes sense, if the investor believes future inflation will trend higher than the breakeven rate (real rate).

Based on the mean-reversion theory, a simple indication about future inflation is the long-term average inflation rate of the US CPI Urban Consumer index, which is now at 2%. Another market sentiment indicator of the inflation in 10 years is the Inflation Swap 5y5y, which currently stands at 2.15%.

At the end of November 2020, the break-even rate is slightly below the two indicators mentioned above, which is on the margin a (weak) buying signal.



US Loan Index Total Return - Attractive Long Term Yield Generation



List of Abbreviations

Capital Securities (Or preferred securities): Are fixed income securities combining features of bonds and preferred stocks.

CDS: Credit default swaps transfer credit event risk to another party in exchange of a perdiodically paid premium. CDX index covers the US IG-, iTraxx the EU IG- and iTraxx crossover (XO) the EU HY market.

CLOs: Collateralized loan obligations are structured finance securities collateralized predominantly by a large pool of different loans.

Default Rate: Number of defaulted corporate issuers of leveraged loans and high yield bonds.

Loans: Are syndicated, public tradable loans. Synonyms are «syndicated loans», «loans», «leveraged loans» and «bank loans».

OAS: Option-adjusted spread is the yield difference of an interest paying security to the risk free rate considering embedded options.

TIPS: Treasury Inflation-Protected Securities are US government linked to the US CPI Urban Non-Seasonally Adjusted.

Up-/ downgrades: Rating actions of Moody's and S&P of up-or downgrades of US high yield bond issuers denominated in USD.

Up-/ downgrade ratio: Number of upgrades of total rating actions.

Recovery Rates: Bond issuer-weighted recovery rates express the principal and accrued interest on defaulted debt that can be recovered in percentage of face value. Example:
Expected loss rate if US HY defaults were 10%: 10% ./. Estimated average recovery rate of ~30% = -7%; Example for Loans:
Expected loss rate if US Loan defaults were 10%: 10% ./. Estimated average recovery rate of ~65% = -3.5%;

Data and Price Sources

Alpinum Investment Management	Federal Reserve Bank of St. Louis	Palmer Square indices
Bank of America Merrill Lynch indices	Markit CDS indices	Preqin
Bloomberg	Moody's Investors Service	S&P
The Federal Reserve	J.P. Morgan	

Disclaimer

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